

Statement of

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Consumer Information and Choice
in the Airline Industry**

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This Commission has been asked by Congress to study two principal issues: whether the financial condition of travel agents is declining, and if so, the effect that will have on consumers; and whether there are impediments to information regarding the services and products offered by the airlines, and if so, the effects of those impediments on travel distributors and consumers. In answering these questions, the Commission has also been asked to pay special attention to the status of small travel agencies, with less than \$1 million in yearly revenues. It is significant that in both questions, Congress has asked the Commission to keep the best interests of consumers firmly in mind.

In its final report, this Commission is asked to make recommendations that would help both travel agents – especially small travel agents – and consumers alike. Orbitz would like the Commission to consider the following recommendations: Be on the side of technology innovation and consumer choice. Technological progress has made massive contributions to our nation’s productivity. Let it continue to do so in the travel industry. Let free market competition work in the travel distribution channel so prices fall and new technologies flourish. And that means three things:

- First, consumers should be free to decide how and where they want to purchase travel without regulatory schemes that interfere with the consumers’ choice.
- Second, travel suppliers – who are the consumers of the distribution service provided by CRSs, agents, websites, and others – should remain free to choose which channels to use to distribute their products, based on the cost and quality of the distribution service they receive. That’s how it’s always worked, and with technology advances bringing new, lower cost options to the marketplace, it’s more important than ever for suppliers to be able to operate in a distribution marketplace just like consumers of distribution services in other industries do.
- Third, and most importantly for this panel, travel agents, in particular small travel agents, need to be given meaningful, competitive choices among the computer systems they must use to view travel suppliers inventory and book reservations for customers. New entry and new competition in the computer reservation system market will let the travel agent choose the most efficient system. But some regulatory change may be required to make that choice meaningful. Travel agents need to be freed from existing, onerous CRS

contracts, without penalties. In an Internet world, new choices should be just a click away for agents, as they already are for consumers. Unfortunately, because of current CRS regulations, travel agents do not have the choices they otherwise would have.

We make more detailed recommendations near the end of this testimony.

Status of Travel Agents

In this Commission's first hearing, Mr. William Maloney, the Executive Vice President and Chief Operating Officer of ASTA, offered the best insight into the financial status of the travel agency industry. His data showed clearly that the number of travel agency firms grew rapidly from 1978 through about 1986, when the growth rate slowed. The number of firms remained nearly constant from about 1990 through 1994 and then began a rapid decline that continues today (see ASTA Chart 1, attached). The data showing the number of travel agency locations is about the same. Most importantly however, Mr. Maloney's data shows a revealing statistic – the dollar value and number of actual air tickets sold through retail travel agents has remained on a constant upward trend through the entire period – until the tragedy of September 11 violently disrupted the entire travel industry (see ASTA Chart 3, attached). One obvious and inescapable conclusion from this data is that the travel agency industry was and is undergoing a consolidation beginning in about 1995 that is unrelated to the volume of tickets being sold.

What could be driving this consolidation? It is likely two things. First, it is, to steal a phrase used by the Wall Street Journal to describe a phenomenon in the airline industry, the Walmartization of travel distribution where volume wins and the small retailer loses. This is a phenomenon that is happening to many small retail businesses across the country. In travel distribution however, the way travel agents are compensated, and the way they pay for (or get paid by) the computer reservation systems they use, so strongly favor high volume, it was inevitable that large agencies would thrive, literally at the expense of small agencies. Second, the technological revolution that has dawned on the distribution of travel began with the introduction of the paperless ticketing in 1995 and has continued to add new ways to buy travel that offer consumers more choice and convenience and lower the distribution cost for suppliers. It is Orbitz' view that the introduction of this new technology offers consumers a new choice for

purchasing travel, but is no more likely to eliminate traditional travel agents than Amazon.com has eliminated bookstores.

Traditional Agent Compensation Structure and CRS Fees Contribute to Consolidation

Travel agents used to receive compensation from the airlines of two types: a base commission on every sale and, if they earned it by moving market share from one airline to another, an override commission. Pay-for-performance override commissions are typically only available to large travel agents. The bigger the travel agency, the more sales can be drawn to the airline paying the override. This revenue stream is generally not available at all to the small travel agent who cannot have a significant impact in an airline's market share. As airlines worked to lower their distribution costs and to incorporate lower cost ticketing alternatives, base commissions were decreased and eventually eliminated by the airlines in lieu of less expensive alternatives made available by new technology. The impact of these changes was felt most by small agencies that did not have the alternate revenue stream of override commissions.

A second, and much more insidious, economic factor that compels travel agency consolidation is the cost of using a CRS. The CRS is paid a booking fee by the airline for every booking made via its system. Thus, the more travel agents that use the system, the more money the CRS makes, paid for by the airlines. The CRS has a strong incentive to get and maintain the use of its system by the largest travel agencies who have the most agents and sell the most tickets. Small agencies with low volumes do not generate significant booking fees for the CRS. Thus, the CRS compels a small travel agency to pay for use of the CRS system. In contrast, a CRS company actually pays the largest agencies to keep using its system. The effect of this is that as the small travel agent pays each month for the use of its CRS, it may as well be writing a check directly to its largest travel agent competitor.

New Technology has Given Consumers New Choices, and Changed the Role of Agents

The introduction of the paperless ticket, followed by the introduction of the Internet has opened new and convenient alternatives for the consumer, but has also changed the role of traditional travel agents. Prior to 1995 we had a distribution system that needed ticketing locations in as many places as possible in order to get paper tickets on short notice to as many last-minute business passengers as possible. Travel agencies were usually the most cost-

effective way to do that. We built a system of 34,000 agency locations across the US. In many urban business districts we had a travel agency on almost every block.

When paperless ticketing arrived, and particularly business travelers flocked to it, the industry did not need as many agency locations as before. Having your travel agent only a block away became less important to more passengers, because the passenger now had the convenience of just taking that locator number to the airport, rather than a paper ticket. No one should oppose paperless ticketing – it is popular with consumers and suppliers alike, and there is no going back – but it is the driving force behind a major adjustment that the agency world had to make beginning in the mid-1990s.

Needing fewer agency locations, did not mean we needed travel agents less, however. From the data provided by Mr. Malone we can see that as the number of agency firms and locations went down, the number of tickets sold by agents kept going up, and the total value of air tickets sold by travel agents kept going up every year from 1995 through 2000. In fact, the only force great enough to make them go down was September 11, which devastated every aspect of air travel.

What we see very clearly in ASTA's charts is that consumers may need fewer travel agency locations than we had pre-1995, but they need travel agencies no less than they ever did.

The Internet is the Latest Form of New Technology Affecting Travel Distribution

Perhaps the clearest success story of Internet commerce has been in the distribution of travel. Today, travel represents the largest category of Internet sales. Travelocity launched in 1996, and Expedia later that same year. But even counting all online agents and all individual airline websites, the Internet got off to a slow start in travel, not passing 2% of all air travel sales until 1998. Today, even with Orbitz having launched in June 2001, it is the individual airline websites, and not third-party websites such as Expedia, Travelocity, Trip.com, and Orbitz, that represent the fastest growing segment of air travel sales on the Internet.

There has been a lot of speculation about the Internet displacing the traditional travel agent. The facts are that today, about 15 percent of all airline tickets are sold via the Internet. Looking more closely at just that 15 percent sold online, 58 percent of that is sold directly by the airline websites and 42 percent is sold by third-party sites such as Expedia, Travelocity, Trip.com, and Orbitz. There are some people for whom the Internet is a convenient tool, and

many people for whom it is not. There are some travel needs that can be best met for many people on the Internet – 24-hour, do-it-yourself access; a simple routing; a need to have a low fare. This was largely business that had not been cost effective for travel agents to perform. Where the travel agent adds the most value, and earns the most in commissions and/or customer service fees, is the more complex trip and the special vacation that requires expert knowledge of a particular area. Travel agents will under any circumstances go on making a large portion of travel sales, and will in particular make a disproportion of the high value sales.

In short, the low margin business will move in part to the Internet, where it can be done more efficiently. And the high margin business is likely to stay in large part with the traditional travel agent, where personal advice will be more valued by the consumer, and the consumer will be more willing to pay more for that service. It is actually an attractive business model for travel agents, but it does mean changing the way they do business to adapt to these changed circumstances. And change is never easy.

The agency business is changing. It is becoming more consolidated – doing more business through fewer locations and fewer firms. It is adapting to new technology as we heard from Mr. McNair, who testified at the first hearing. He testified that his agency has developed an automated way to search the Internet as well as the CRS, in an effort to best serve his clients. It is also becoming more oriented to higher value purchases, less toward selling the quick and the cheap, and more to working out compensation structures that have consumers paying for the higher level services they are seeking from travel agents.

All this is evidence that travel agents, who have always shown a flair for adapting to change, continue to have that ability in great abundance. To paraphrase Mark Twain, the death of the travel agent is greatly exaggerated.

There is no clearer sign of that than the trend of traditional travel agents toward using the Internet themselves to offer a wider array of services and information to their customers. The Internet is not the travel agents' enemy. It is simply a new tool. ASTA itself has in other settings recognized as much. I am submitting with my testimony a very thoughtful brochure that ASTA publishes about the Internet, and I commend it to your attention.

Particularly in America, successful businesses do not fight technological change – they put it to work for them.

In air travel as elsewhere, the Internet has a valuable role to play for consumers. For those who want lots of information about books, or clothing, or air travel, it delivers a lot of information in a very short amount of time. For example, in response to a simple domestic round trip request, Orbitz will typically search over two billion fare and schedule combinations, and will display for the consumer up to 400 options, ordered by lowest fare first, without favoring any airline over any other, all in a few seconds. If the consumer wants lots of information about lots of flights on lots of airlines offering lots of low fares, Orbitz offers more of that information than is available anywhere else to the public. And the public does not have to buy anything or pay anything to have the benefit of all that information. When it comes to ensuring consumer information and choice, we have definitely moved the ball forward in a very substantial way. We use the Internet and a whole new generation of computing technology to do that.

But the fact is, some people really want all that information, and some people don't. Some people want to see all the options, others want somebody to tell them which is the best option. Not everybody wants the same thing, and given a choice, not everyone will choose the same thing. Many will prefer the Internet for some kinds of travel, and agents for other kinds of travel.

Our point is simple: we believe consumers ought to have the choice. We believe consumers, not government, should decide which works best for each person on any given day. In our view, people will continue to want both Internet and traditional travel agent options to be available to them, they will use both, both will continue to exist side-by-side, and the consumer will be better off for it.

Webfares

The second question posed by Congress for this Commission addresses impediments to information about airline products and services. Much of this debate has focused on the availability of webfares – deeply discounted fares the airlines have chosen to sell only through low-cost distribution channels. For several years before Orbitz existed, airlines put fares on their own websites that they did not sell through other channels, not even through their own call centers and ticket counters. This reflected one simple fact: an airline can sell a ticket through its own website at lower cost than it can sell through any other means. In a sense, there was nothing new about this – airlines had long had the right to sell fares in some places and not others. Even

prior to deregulation, airlines sold low fares – called consolidator fares – through some outlets but not others. What was new was simply the tool – the Internet.

Orbitz' low costs and competitive, consumer-focused approach has made webfares more widely available than they were. And we did it the old-fashioned way – we earned it. Our critics like to overlook the fact that we receive webfares not only from our airline founders, but from 37 other domestic and foreign carriers as well. All airlines serving the United States were offered the same, simple bargain – to allow Orbitz to sell all of their fares, including webfares, in return for lower cost of sale on every ticket we sell for them. And that's an offer we make to every airline.

Thus, Orbitz took fares that were available only on one airline's website and made them available both on that website and on Orbitz and we did it by a mechanism available to others, but not used by anybody else – we lowered the cost of making a booking. Then other online agents felt they had to compete to get those fares, and they did compete, and now they have the webfares too. After all, the arrangement Orbitz has to get those webfares is strictly non-exclusive – Orbitz gets the webfare, but the airline remains free to also sell that fare through any other outlet it wishes. The first result is that the other major online agencies, Expedia and Travelocity, have competed to get those webfares, and they have largely succeeded. Attached to my testimony is a full page ad recently taken out by Expedia, trumpeting that it has webfares. Obviously webfares are not exclusive to Orbitz, and they never were.

The question remains, however, what does all this mean for traditional travel agents. Today travel agents can sell webfares, but their CRSs typically cannot. The travel agent can go to the airline website, which in many instances has special features for agents to use, and purchase any fare, including a webfare. Or the agent can book on Expedia, Travelocity, or Orbitz, all of which offer webfares, on behalf of his or her client. Now that the agent often gets no base commission from the airline for selling through a CRS, the impediment to an agent using a website to sell a webfare is less than ever.

Why do CRSs not have webfares to sell? Because they have priced themselves, and unfortunately the agents who depend on them, out of the business of selling webfares.

The central point here is that selling an airfare is itself a business. The distributor charges the airline for the service of selling an airfare. An airline does not simply make an airfare available for sale on Sabre, to use the largest CRS as an example – by so doing it agrees to pay

Sabre whatever Sabre charges for selling that ticket. The airline is buying a distribution service from Sabre. As with any other service any of us needs, the airline does not want to buy that service unless it is reasonably priced.

In the view of the airlines, Sabre in particular, and the CRSs in general, charge so high a fee for each booking routed through a CRS that the lowest fares an airline offers are simply not economic to sell through a CRS. Unfortunately for the airline, that means the agents who use that CRS cannot sell those webfares through that CRS. But the airlines view the cost of the CRS as being so excessive that they have to pay the penalty of having fewer avenues through which to sell their cheapest tickets in order to avoid paying such high distribution costs.

What this means is that the agent is not getting the webfares on their CRS because the CRS has priced the agent out of the business of selling those webfares.

It also means that the CRS has grabbed for itself nearly all the money the airlines have been willing to pay to have an agent using a CRS sell a ticket. An historical perspective would be useful here:

We'll assume a three-segment ticket with an airfare of \$250. Fifteen years ago, the airline would have paid about \$30.25 in total distribution costs; the CRS about \$5.25 as a booking fee and the agent about \$25 as a commission. So of the \$30.25 total, the travel agent would have received about 83%, and the CRS share would be about 17%. Let's compare that to today. For the sale of the same ticket today, the airline would pay the CRS about \$12 as the booking fee, would pay the agent nothing in base commissions and, on average, about \$5 in other kinds of commissions. So today, about 29% of what the airline pays for this sale goes to the agent, and about 71% goes to the CRS, almost a perfect reversal of the situation that existed just fifteen years ago. The travel agent's share of what an airline is willing to pay for an agent sale on a CRS has fallen in this example from about 83% to about 29%. The CRS has taken the rest.

CRS Regulatory Changes are Needed to Aid Competition

The high CRS booking fees that have burdened airlines for years have now become a major problem for travel agents as well. Agents are being priced out of selling the lowest airline fares by costs that are decided by somebody else and are paid by somebody else to somebody

else. Travel agents have lost control over the cost of the service they sell to airlines, and until they get some of that control back, they will not have much control over their own fate.

The federal government long ago found CRSs to have monopoly power. Eighteen years ago the federal government set out to deal with the monopoly problems posed by the CRSs, by promulgating CRS rules to deal with the three principle forms of monopoly abuse that the government found:

- The rules limited display bias. While they never attempted to eliminate bias, they did limit it, and have in that sense been fairly successful.
- The rules attempted to prevent anti-competitive terms from being imposed by CRSs on travel agents, in contracts designed to make it very difficult for an agent to ever choose or use another CRS. This aspect of the rules had good intent, but largely failed, as the CRSs found more than enough loopholes to skirt the requirements.
- The government found serious monopoly power problems in the high booking fees CRSs charged airlines, but the rules never seriously attempted to correct the problem, and have utterly failed to do so. CRS booking fees have steadily climbed from levels the government had already found to be excessive.¹

Travel agents are now paying the price for the failure of the CRS rules to find a mechanism that would keep CRS booking fees from being so high as to harm the interests of travel agents, in addition to harming both the interests of consumers and airlines by raising the costs of air transportation in general.

The Importance of CRS Booking Fees

It is easy to underestimate the importance of CRS booking fees, but important not to. It is easy to dismiss them as only being about \$4 per segment, how big a deal can that be? It can be a very big deal, for airlines, for travel agents, and ultimately for consumers who pay these costs.

U.S. airlines now pay about \$2.2 billion per year in CRS booking fees. The average CRS booking fee paid in the U.S. is a little over \$4.30 per segment. An airline that agrees to be an associate of Orbitz, meaning it agrees to put all its public fares on Orbitz (and retains the right to also put them anywhere else it wants) pays a net booking fee, after receiving an offset from

¹ For a more complete discussion of CRS booking fees and the Government's findings with respect to those fees, see excerpts from Orbitz's Answer to Galileo, attached.

Orbitz, that is less than two-thirds of that amount. If all CRSs and all websites concluded that they had to match Orbitz's offer for the cost of making a booking, that would save the airlines over three-quarters of a billion dollars per year in CRS booking fees. Put another way, it would make selling fares through travel agents over three-quarters of a billion dollars per year less expensive for airlines. That would make selling through travel agents a far more attractive proposition for airlines. That in turn could change a lot of things.

Orbitz Should Not Be the Focus of this Commission

Orbitz is a travel agent. We are a type of travel agent often referred to as an online agent, meaning we conduct our travel agency business over the Internet. We are the third largest online travel agent, behind Expedia and Travelocity. The downward trends in agency locations and agency firms, as shown by ASTA's data, started six years before Orbitz existed. Orbitz has less than 2 percent of the domestic air travel market and does not sell travel that originates outside of the U.S. at all. It's share of total travel sales, including air, hotel and car rentals, is a fraction of one percent. Obviously, if Orbitz vanished altogether tomorrow, not a single thing would change for the traditional travel agents, large and small. The trend toward consolidation would continue, airlines would still choose the most cost effective distributors to sell their webfares, the traditional travel agent would still be stuck with antiquated, high-cost CRS technology that would keep them from getting webfares, and they would still be stuck with a CRS-related compensation structure that makes no sense for anyone.

Like any agent we respond to customer inquiries, we provide information about travel options; we book a ticket if that is what the consumer wants; we provide follow-up service to the customer in the event of changed plans, canceled flights, and the like; we charge the customer an agency service fee; we receive from the airlines a commission or similar payment (though in recent months we've had to respond to changed airline views as that question, as have other agents); and, we receive payments from the CRS that makes our bookings, as any large agent does.

What is different about Orbitz is this: we offer to return a portion of the payment we get from our CRS to the airline on which that booking was made, if that airline agrees to make available on Orbitz any fare it makes available to the general public elsewhere. And we make that offer to any airline. That one feature is why you got to hear so much about us in your first

hearing, despite the fact that you are not called the National Commission on Orbitz. We are not just a competitor, we are a price competitor. We don't particularly compete on travel agent commissions, where now we are suddenly a little higher than average. As a travel agent we are generally in favor of higher agency commissions. We don't particularly compete to reduce CRS payments to agents. As a travel agent we are in favor of CRS payments to travel agents. But we are a price competitor on the largest cost to an airline of selling through a travel agent, the booking fee charged the airline by the CRS. And that makes us less than welcome by those who not only charge high CRS booking fees, but want to go on raising booking fees more and more every year.

Price Competition

Orbitz is the first serious marketplace attempt to provide price competition for the CRSs. Orbitz says to any airline:

- We will display and sell your fares in a completely unbiased way.
- We will offer you, in addition, the option of getting from Orbitz what is in effect a rebate on the CRS booking fee an airline pays for a ticket booked on Orbitz, if you agree to make available to Orbitz any fare you make available to the general public elsewhere.

We are offering lower cost of booking on all fares, in order to get all fares. We expressly say it is fine for the airline to decide to also put those fares anywhere else it wants, that is not our concern. There is nothing exclusive about our arrangement. But we are offering what might be thought of as a volume discount option – the airline has the option to pay a bit less if it is willing to allow us to sell more of their product.²

That is what normal competition looks like in a distribution marketplace.

The first to scream were Expedia and Travelocity. Airlines pay the full CRS booking fee when booked on Expedia and Travelocity, and those websites tried to argue that Orbitz was getting webfares that they could not get. The fact was, they were not getting the webfares

² The value of this effective rebate on the booking fee is especially significant to low-fare airlines, and in turn to their passengers. Because the same booking fee is charged to all airlines, the fee comprises a larger percentage of the fares charged by low-fare airlines than by other airlines. In effect, the booking fee acts like a regressive tax, imposing higher costs on the low-fare airlines and the most price-sensitive consumers that are least able to pay them. Attached with this testimony is a letter from Michael J. Conway, explaining how National Airlines benefits from this and other services provided by Orbitz.

because they were refusing to engage in price competition to get those webfares. They wanted their old high pricing structure protected. They demanded government get those fares for them to sell without regard for what they charged to sell those fares. But government saw through that anti-competitive scheme, allowed Orbitz to proceed, and did not rush to protect Travelocity's and Expedia's high prices. Finally Expedia and Travelocity realized their cries of wolf would not get government to guarantee their high prices for them. They started making serious offers of lower prices to airlines for the booking of fares, and the result, as you can see in the Expedia ad, is that the airlines were only too eager to make their webfares available.

The next step is the CRSs. Sabre and Galileo are going down the same path that Expedia and Travelocity went down. They are calling for government to require that they have "access to all fares." By that they mean that airlines should have to sell all fares through their distribution service no matter how much they charge for that service. In short, they are asking for governmentally granted monopoly pricing power.

It is not hard to predict what the consequence of that would be. If the government required everybody to sell their house through the Multiple Listing Service, what do you think would happen to the price you would be charged to sell through MLS? If the government required everybody to have their car serviced at the dealer they bought it from, what do you think would happen to the price you would be charged to have your work done at the dealer?

The result would be that booking fees, already excessive, would go even higher. Travel agents would be made into an even more expensive channel through which to sell tickets, through no fault of their own.

The alternative is to let competition work on the CRSs, as it has already worked on Expedia and Travelocity. We may find before too long an ad like the Expedia ad, announcing that Sabre now has webfares, and to see your local travel agent.

Paul Rudin made the observation in your first hearing that the reason airlines reduced base commissions is that they could. Let me add a corollary to that: the reason CRSs don't lower the cost of selling through a travel agent is because they don't have to. If government opted to protect them from competition, by requiring that all fares be sold through all systems, without regard to the price each system charged, they would never have to. If they are left to face competition now not only from Orbitz, but (however reluctantly) from Expedia and Travelocity,

they will find that they have to lower the cost of selling through a travel agent and that in return they can get themselves and the agents access to webfares.

There is no question that the CRSs have the ability to do all that – what has been lacking is the necessity of doing it. Competition will provide that necessity.

Consider for a moment that for over 70% of all tickets, there is a partnership involved in the sale of each ticket, and that partnership is made up of three parties: the airline that provides the actual air travel, the CRS that serves as the technological middleman between the airline and the agent, and the agent who brings the customer to the table. These are hard times in air travel, in the aftershock of September 11, with air travel revenues still down about 20% over a year earlier. You would expect all three partners in that sale chain to be sharing the pain of that downturn.

The airlines certainly are: for 2001 they lost \$7.7 billion, nearly double their worst previous year in history. In the first quarter of this year they lost another \$2.4 billion. At the same time the travel agents have had their base commissions cut to zero, agency locations and firms are being closed every month, and post-September 11, for the first time in modern history, agency sales of air tickets are down. Yes, agents are adapting to change by charging service fees and shifting the nature of the service they provide, but they are having to make those changes in the worst possible circumstances, which is a recession combined with a dramatic fall in air travel volume due to September 11.

And what about the third partner, the CRSs? Consider the recent financial results from Sabre.

- Their operating profit (operating income, continuing operations, excluding special items) for the first quarter of 2002 was a record \$141 million, up from \$115 million for the same quarter a year earlier.
- Their net profit (net earnings, continuing operations, excluding special items) for the first quarter of 2002 was a record \$84 million, up from \$63 million for the same quarter a year earlier.

- Their look-ahead for profitability for the full CY2002 is very rosy – they expect earnings per share to be up 12-18% for CY2002 over CY2001.³

So let's recap: in first quarter of this year, with the travel industry reeling from the combined impact of recession and September 11, and with Sabre presumably suffering the full impact of the various sins it accuses Orbitz of committing, Sabre pulled in record profits, up dramatically from a year earlier when there was no recession, no September 11 impact, and no Orbitz.

In the first quarter of this year, Sabre had an operating profit margin of 26%, extraordinarily profitable by comparison to most US industries. For the same quarter the airlines had an operating profit margin of negative 14%, and hundreds of travel agencies went out of business. And you are being asked to guarantee that Sabre can charge airlines even more in the future, and that they can make selling through travel agents even more expensive.

Anti-Trust Issues

There were in your first hearing some loose and unsupported remarks made about anti-trust violations and conspiracies. Those are very serious matters, and should not be the subject of casual comments.

It might be useful for you to know about the anti-trust and competition review of Orbitz.

Over a year before Orbitz launched, we went to the Department of Justice and asked it to review us. We did not want to build a business, only to discover later that we had a problem. We gave them every agreement, every contract, every organizational document we had. The agreement by which any airline can opt for lower net booking fees in return for making webfares available on a non-exclusive basis to Orbitz – Justice got every page of it. They examined everything about our business, and did so for over a year before we launched. We kept them fully informed about our launch date. They had the option of moving to stop us if they saw anything amiss in any of our agreements or business plans, and plenty of time in which to do so. And they chose not to stand in our way and not to ask us to modify any of our agreements or plans.

³ Sabre is not alone. Cendant, the parent of Galileo (the second largest CRS), projects that 2002 will be a record year for Galileo's distribution services. Amadeus had outstanding results in 2001 and a first quarter this year that was not only very profitable, but was also "ahead of expectations."

At the same time we went to the Department of Transportation and gave them all our agreements, contracts, business plans, and the like. They took a full year to review everything. On April 13, 2001, they found no competitive problem with Orbitz, expressly concluded that they would not stand in the way of Orbitz's launch nor seek any modifications to our agreements or plans, and in fact noted that we were likely to have a pro-competitive effect on the marketplace. Specifically of our arrangement with associates to get webfares in return for lower booking costs, DOT concluded:

Our conclusion not to take action to require modifications of the MFN clause at this stage reflects the inherent desirability of having new entry in the comprehensive online travel agency business and having as much competition in the marketplace as possible to maximize consumer welfare.

At the same time, we provided the same kinds of information to the DOT Inspector General, and he and his staff reviewed our business for months. The IG's findings basically paralleled the DOT's.

In particular, an issue is sometimes raised that Orbitz is a collaboration of five airlines, in that the current investors in Orbitz are those airlines.

Ownership is not a crime in America, but certain kinds of behavior are. There are many businesses that are invested in by companies that are competitors. The Justice Department and the Federal Trade Commission have even published guidelines for business enterprises that are collaborations of competitors. Those guidelines state that while there clearly are some kinds of collaborations that are anti-competitive, there are many that are pro-competitive. The Guidelines state that "[s]uch agreements may be pro-competitive, for example, where a combination of complementary assets enables products more quickly and efficiently to reach the marketplace." The Guidelines in general "recognize that consumers may benefit from competitor collaborations."

There is no shortage of such airline collaborations in the travel industry; many of which have been in business for a very long time. CRSs and travel agencies have long been major customers for a number of airline-created, airline-owned companies, including: the Airlines Reporting Corporation (ARC), which processed \$83 billion in sales for U.S. travel agencies last year; the Airline Tariff Publishing Company (ATPCO), which collects and disseminates airline fare and fare-related data to CRSs; and ARINC and SITA, the telecommunications backbones of the CRS and airline industries.

In reality, the simple fact of competitors meeting in a room is very common. Every trade association is a common venture of competitors, and the cause of endless meetings behind closed doors. If simply being part of the same organization, and sitting together in the same meeting rooms, were an anti-trust violation, then every trade association in the Washington area would be out of business, including such fine associations as ASTA.

More specifically on the subject of Orbitz, the Inspector General was asked, after his extensive review of Orbitz, whether Orbitz raised increased opportunity for collusion among airline competitors. His answer, part of a series of written responses to the Senate Commerce Committee, was:

We do not see anything unique to the structure of Orbitz that would encourage or facilitate collusion on pricing. The airlines will have no greater access to each others' fares than they currently have through browsing their competitors' websites and purchasing CRS data.

Orbitz has, often at its own request, been one of the most anti-trust scrutinized entities in history. You can have a high degree of confidence that if there were an anti-trust or anti-competitive problem here, somebody in one of these watchdog agencies would have found it by now.

Finally, in the long term, the airline investors in Orbitz hope to have their ownership substantially diluted by new non-airline investors, through phased public stock offerings. The present investors in Orbitz made that investment because no one else was willing to step up and take the risk of an unproven technology. It is now a proven technology. Having launched the company successfully, we are now in registration for an initial public offering. As Orbitz becomes more established, it is anticipated that the airline stake in Orbitz will diminish.

Attacks on Orbitz

Important as we believe Orbitz is, even we would have to admit that the degree of rhetoric and attention focussed in your first hearing on Orbitz was way beyond the significance of Orbitz to the larger mission given to you by Congress. You have to ask yourselves why some chose to focus so extensively on Orbitz.

The fact is, we are a new entrant and a new price competitor. We represent price competition for the CRS booking fee, an area that government agencies have long complained has little or no price competition. To make matters worse, we are taking on those who not only

can and do excessively price their product, but also have had that power for over two decades. They have grown so accustomed to having it that they now believe they are entitled to it. In fact, they think government ought to guarantee it to them. And that is what they would like you to help them with.

Hell hath no fury like a monopolist rudely awakened by the faint whiff of a little actual price competition.

They have done their best to stampede travel agents into believing that the Internet is the problem, that Orbitz is the problem, that anybody other than the CRSs is the problem. Given the fact that travel agents are having to make difficult adjustments, to recession, to paperless ticketing, to declining commissions and rising fees to consumers, to September 11 fears and security delays and inconveniences – agents are in a difficult period and some are vulnerable to such tactics.

If the question is simply who can raise the loudest ruckus, there is no question they will win that contest. Orbitz is a small upstart, taking on one of the biggest, most entrenched oligopolies in the US economy. Sabre, for example, has about 11,000 employees. Orbitz has about 190. If this is just about yelling, we can't yell as loud as they can.

This Commission is going to need to be able to look behind the yelling and see the facts.

If the Internet is such a threat to travel agents, why did we hear over and over in the first hearing about Orbitz, and never about Expedia and Travelocity? They each sell more air travel than Orbitz does. Why did we not hear about individual airline websites? Together they sell more air travel than Expedia, Travelocity, and Orbitz combined.

If online sale of webfares that agents do not have the ability to sell on their CRSs is such a threat to travel agents, why did we hear over and over in the first hearing about Orbitz, and never about Expedia and Travelocity? They each have webfares. Why did we not hear about individual airline websites? They sell more webfares than anybody else.

The answer is that Orbitz brings new price competition to the booking fee, and the biggest CRSs in response are doing everything they can to turn every issue into an Orbitz issue, no matter how much of a stretch that may be. Expedia and Travelocity never wanted to compete on the booking fee, and have only belatedly moved into that price competition under competitive pressure from Orbitz. The biggest CRSs know that if they can deprive Orbitz of its means of price competition, they can stay with the old ways of monopoly pricing of CRSs long into the

future, and travel agents will just be stuck with the consequences of being the high priced way to sell a ticket, and airlines and consumers will be stuck with paying those high prices.

Options for Remedial Action

While travel agents face in part issues of change that will simply have to be worked through (such as the effects of paperless ticketing, adaptation to the new technologies of the Internet and microprocessing, and the like), and while they also bear the burden that most in the travel industry bears of the combined effects of recession and September 11 impacts on travel, there are also specific problems they face that can and should be remedied. In every instance, a remedy should be adopted only if it benefits both travel agents and consumers, if it makes the partnerships involved in making travel a viable sector of our economy work better than they do today, and if it is pro-competitive.

We would offer the following thoughts on various options for action:

- (1) Travel Agent-CRS Contract Terms. The federal government has long found that CRSs exercise their market power over travel agents by imposing on travel agents contract terms that effectively limit or deny agents the market choice of switching to or using another system. Agents often find themselves in what are, in effect, lifetime contracts. While the CRS rules attempted to deal with this situation, they have proven to be largely ineffective. ASTA has proposed a series of changes in the CRS rules that exemplify the kinds of changes that ought to be made to the rules to allow travel agents to benefit from competition. The changes that need to be made include such reforms as prohibiting productivity pricing, shortening the contract term, preventing the overlapping of multiple contract terms, barring liquidated damages clauses, and similar measures. The objective should be that any travel agent should never be far from a point in time when he or she has a no penalty option to change to a different CRS or to a different kind of automation system. The agent may never actually change systems, but the fact that he or she has the option to do so will get the agent a far better deal than they can get today. Many agents today can be taken for granted by the system they use. If they could no longer be taken for granted, they would find that some of the compensation they have lost to their CRS would come back to them. Today we tell agents that they need to operate in a competitive

marketplace, but we don't let them have the benefits of competition where they need competition. We need to remedy that. Important as it is to promote choice for consumers, it is also important to provide choice for travel agents. When they have real choice, they will get systems that better meet their needs, such as systems willing to make the pricing moves necessary to get webfares, systems that will pay them better for the value they create for the system they use, systems that will better support the record keeping and customer service features that make them more productive and better able to win and keep customers.

(2) Smaller Travel Agencies. The statute specifically tasks this Commission with addressing the question of smaller travel agencies, and there is no doubt that in the current consolidation trend among travel agents the agencies going out of business are mostly the smaller firms. To some extent that is an inherent part of the consolidation trend. To some extent it is the inherent economies of scale. But it is also more than that. CRSs have developed programs to pay incentives to the large agencies, but not to smaller agencies. It is understandable that larger agencies would receive larger payments to reflect their productivity advantages, but not that the smaller agencies would get none at all. This practice exacerbates the gulf between large and small agencies. It is the smaller agencies that most suffer from the lack of bargaining leverage due to the harsh CRS contract terms under which they labor. Modifying the CRS rules to create real choice for agents among systems would also have the effect of encouraging CRSs to treat their smaller agencies better with respect to these incentive payments, and would therefore make the current disadvantage under which smaller agencies labor less extreme.

(3) Let Price Competition Work to the Advantage of Travel Agents. Agents need to be out from under the burden of costs that they do not control. Selling through a travel agent has been made expensive not by any payment to the travel agent, but by continued increases in already excessive CRS booking fees, unrestrained by market forces. Normal market forces need to be brought to bear on CRS booking fees. That means not granting CRSs a governmental right to get webfares without regard to what they charge for their services. It means leaving CRSs to conclude, as Expedia and

Travelocity have before them, that the only way they will get webfares is to engage in the price competition that is normal throughout the American economy.

(4) Travel Agents Need the Option of Moving to New Technology. Agents today are using CRSs that are mainframe technology that was cutting edge in the 1970s. It has been patched and upgraded continuously, but at its heart, it is still 1970s mainframe technology. New technology is based on microprocessors and communicates via the Internet. The CRSs have not made the switch, but some of the Internet companies, including Orbitz, have. It is only a matter of time until one of these new technology companies makes an offer to travel agents to function as their automation system, either in whole or in part. To break into that business, they will offer impressive new features, a substantially improved economic package, and the promise of things to come that the older technology will simply not be able to match. Nothing should be done that would impede these new competitors with new technology from stepping into the travel agency arena. These new competitors are most likely to come from the Internet ranks. Orbitz, for example, has recently discussed a partnership with AQUA, a major software provider to travel agents. You have had testimony that even where an agent wants to make a booking of a webfare on the Internet, it may not be convenient to do so because of the problem of keeping records of the transaction. AQUA would like to offer agents software that would solve that problem. We need to make sure that barriers are not thrown up in front of these kinds of new options for agents, without regard to which company may offer them.

(5) Do Not Make New Options for Agents from the Internet More Difficult by Applying the CRS Rules to the Internet. The CRS rules, as is often the case with rules designed to limit the abuse of monopoly power, have over the years shifted to a more mixed role of limiting monopoly power in some respects and entrenching it in others. Some features of those rules now serve anti-competitive purposes more than pro-competitive purposes. Two years ago we had the spectacle at DOT of the largest CRS, Sabre, which DOT was inclined to rule was no longer covered by the CRS rules, rushing into DOT to argue that they were really still covered by the rules. They did so because there are aspects of the rules that work to the advantage of the biggest CRSs. The most egregious of these is the mandatory participation rule. Sabre would

like that rule to apply to Orbitz in the hopes that it could then argue that it required the owning airlines to put all their fares on Sabre, without regard to what Sabre charged in the way of booking fees. We believe that reading of the mandatory participation rule is mistaken, but Sabre wants the opportunity to tie us and the Department up in years of wrangling over the issue. If the Internet is to serve as a springboard of new competitive options for travel agents, it cannot be tied up in that kind of anti-competitive restriction. Other aspects of the CRS rules make no sense on the Internet. For example, as discussed above, the rules were designed to address problems growing out of the restrictive kinds of contracts CRSs have with their users (the agents). Internet companies, in contrast, typically have no contracts with their users. Their users are in fact free to try any other website and to buy on any other website, all at the click of a mouse. By the same token, Orbitz has a contractual obligation to have no display bias whatsoever. A rule that merely requires us to limit bias to the kinds of things that are necessary when operating older mainframe technology would set a lower and ill-fitting standard.

(6) Do Not Allow Travel Agents to be Tied to One Technology. In America, technology never stops changing. Horse-drawn carriages, steamboats, the telegraph – they all had their day of being on the cutting edge, and then they were surpassed and left behind. Agents have enjoyed the use of a great tool, the CRS mainframe technology of the '70s and '80s. It was cutting edge technology in its day. But it is now slow, cumbersome, difficult to maintain, and expensive to operate. Like every technology, its day is passing. The microprocessor technology that Orbitz uses, and that is available to anybody, can do searches that are thousands of times more comprehensive than what the CRS mainframes can do, and do it with computers that fit in a small room, as opposed to take up more than a football field. We do that search that is thousands of times better for a few pennies on the dollar of a CRS mainframe's costs. In the new technology, computing power on a per transaction basis is almost free. The old technology will go the way of the horse-drawn carriage. The travel agent, however, is a travel expert who offers personal advice and expertise. The value of that is timeless. The tools a travel agent uses will come and go, but not the travel agent. There are those who can think of a travel agent only as a user of a

CRS. There were travel agents before CRSs and there will be travel agents long after. Do not let travel agents be tied to any one technology. Technologies come and go, but expertise and service can be forever if they have the ability to move from one technology to the next.

(7) Better Security with Less Inconvenience and Uncertainty. The main thing harming travel agents today is the same as the main thing harming the entire travel industry, and that is the aftermath of September 11. In particular, air travel demand remains about 20% below what it was a year ago. Most importantly, the higher yielding business traveler has been the least likely to resume flying. This is the traveler for whom time efficiency is most important, and if he or she can't get that time efficiency, they won't fly. They are also the higher yielding passengers who are key to the revenues of both airlines and travel agents. From travel agents they are more likely to want full service and to be willing to pay for it. They are staying away from travel in droves, and it is a disaster for almost every sector of the travel industry, including travel agents. Because these travelers are so time-sensitive, the added inconvenience, delay, and uncertainty that have resulted from changing security procedures has been a significant factor in the reduced flying by businesses. Secretary Mineta and Undersecretary Magaw have responded by emphasizing that security should be both effective in deterring terrorists and convenient and speedy, including a pledge that security procedures should not delay passengers by more than ten minutes. Nothing would do more to bring the business traveler back than to achieve that goal. This Commission should emphasize the importance of accomplishing that to the future and success of travel agents.

Conclusion

Travel agents are in a difficult time, as is nearly everyone in the travel business. Some of that difficulty arises from factors that are not going to change, or that we can do little about. But there are specific actions that can be taken to improve the situation of travel agents, and they should be taken. Travel agents need the ability to change with technology, to always have the best tools with which to serve their customers, to never be tied to one technology. Travel agents need demand for travel to return to its historic trends; as with any other segment of the travel

industry travel agents cannot advance at the expense of consumers. We all need to bring the consumer back, not to further push him or her away. If we can accomplish those things, the value of what travel agents do in the way of expertise and advice will assure that there is always a large role for travel agents in the travel marketplace.